1965

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American Institute of Certified Public Accountants. Accounting Principles Board

OCTOBER 1965

OPINIONS OF THE ACCOUNTING PRINCIPLES BOARD

6

Status of Accounting Research Bulletins

1. On October 2, 1964, Council of the Institute adopted recommendations[1] requiring that departures from accounting principles accepted in Board Opinions and Accounting Research Bulletins be disclosed in footnotes to financial statements or in independent auditors' reports when the effect of any such departure on the financial statements is material. This requirement is applicable to financial statements for fiscal periods that begin after December 31, 1965.

2. Concurrently, in a related action,[1] Council directed the Accounting Principles Board to review all Accounting Research Bulletins prior to December 31, 1965, and determine whether any of them should be revised or withdrawn.

3. In accordance with this directive, the Board has reviewed all outstanding Accounting Research Bulletins. These consist of Numbers 43 (including Preface, Introduction and Appendices) through 51,[2] except:

   a. Chapter 7C of ARB 43, which was superseded in 1957 by ARB 48;

   b. Chapter 14 of ARB 43, which was superseded in 1964 by Board Opinion 5; and

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[1] Special Bulletin, *Disclosure of Departures From Opinions of Accounting Principles Board,* October 1964. (Reprinted in Appendix A of this Opinion.)

[2] ARB Nos. 1-42 were cancelled and replaced by ARB 43, and by Accounting Terminology Bulletin No. 1, both issued in 1953.

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c. ARB 44, which was superseded in July 1958 by ARB 44 (Revised).

For convenience, individual chapters and sub-chapters of Accounting Research Bulletin No. 43 are, at times, referred to as "Bulletins" in this Opinion.

4. A number of matters currently under study or planned for study by the Board are directly related to matters discussed in the Bulletins. It is the present intention of the Board to make some of these subjects of Opinions as soon as practicable. Accordingly, the language, form and substance of some of the Bulletins may be changed at a later date.

5. Nevertheless, the Board believes that the considerations which gave rise to the conclusions set forth in some of the Bulletins may no longer apply with the same force as when the Bulletins were issued, and that, pending further consideration by the Board, it should revise certain of the Bulletins in order to obviate conflicts between present accepted practice and provisions of outstanding Bulletins which would otherwise require unwarranted disclosure under the action of Council.[3]

6. The Board's review at this time, accordingly, was confined primarily to substantive matters in the Bulletins, and the revisions set forth in this Opinion are made in the light of currently accepted practices followed in preparing financial statements and reporting upon them. In addition, it has approved revisions designed to clarify parts of some of the Bulletins and to express its conclusions on certain matters not covered specifically in the Bulletins.

7. In making its review, the Board has interpreted the disclosure requirement approved by Council to apply, with equal force, to departures from the provisions of Accounting Research Bulletins and Board Opinions that relate not only to accounting principles followed in the preparation of the financial statements but also to the form and content of financial statements and to the disclosure of information. For purposes of carrying out Council's requirement, the Board construes the term "account-

[3] Special Bulletin, *Disclosure of Departures From Opinions of Accounting Principles Board,* October 1964. (Reprinted in Appendix A of this Opinion.)

ing principles" to include not only principles and practices, but also the methods of applying them.[4]

8. Some Accounting Research Bulletins and Board Opinions contain expressions of preference as to accounting principles, including form and content of financial statements and the disclosure of information, although other principles are stated to be acceptable. Under these circumstances, when one of the principles accepted in the Bulletin or Opinion is applied in financial statements, disclosure of a departure from the *preferred* principle is not required. On the other hand, the language of some Accounting Research Bulletins and Board Opinions indicates that one or more specified principles are acceptable, and, directly or by implication, that others are not. In such cases, departures from the *specified* principles must be disclosed.

9. The Preface and Appendices of ARB 43 explain what revisions the Committee on Accounting Procedure made to previously issued Bulletins and why certain revisions were made; therefore, the Board considers this material to be primarily of historical value. With respect to the Introduction, paragraph 8 has been expanded as to disclosure requirements by the action of Council on October 2, 1964.[5]

10. The following paragraphs (12 through 23) of this Opinion set forth the Board's conclusions as to the extent to which currently outstanding Bulletins should be revised at this time. Except for these revisions, these and all other currently existing Bulletins continue in full force and effect without change.

BULLETINS REVISED

11. The following Bulletins are revised, in part, by this Opinion.

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[4] Statement on Auditing Procedure No. 33, *Auditing Standards and Procedures,* paragraph 2, page 40.

[5] Special Bulletin, *Disclosure of Departures From Opinions of Accounting Principles Board,* October 1964. (Reprinted in Appendix A of this Opinion.)

ARB 43, Chapter 1B — Treasury Stock

12. The Board considers that the following accounting practices, in addition to the accounting practices indicated in Chapter 1B, are acceptable, and that they appear to be more in accord with current developments in practice:

a. When a corporation's stock is retired, or purchased for constructive retirement (with or without an intention to retire the stock formally in accordance with applicable laws):

   i. *an excess of purchase price over par or stated value* may be allocated between capital surplus and retained earnings. The portion of the excess allocated to capital surplus should be limited to the sum of (a) all capital surplus arising from previous retirements and net "gains" on sales of treasury stock of the same issue and (b) the prorata portion of capital surplus paid in, voluntary transfers of retained earnings, capitalization of stock dividends, etc., on the same issue. For this purpose, any remaining capital surplus applicable to issues fully retired (formal or constructive) is deemed to be applicable prorata to shares of common stock. Alternatively, the excess may be charged entirely to retained earnings in recognition of the fact that a corporation can always capitalize or allocate retained earnings for such purposes.

   ii. *an excess of par or stated value over purchase price* should be credited to capital surplus.

b. When a corporation's stock is acquired for purposes other than retirement (formal or constructive), or when ultimate disposition has not yet been decided, the cost of acquired stock may be shown separately as a deduction from the total of capital stock, capital surplus, and retained earnings, or may be accorded the accounting treatment appropriate for retired stock, or in some circumstances may be shown as an asset in accordance with paragraph 4 of Chapter 1A of ARB 43. "Gains" on sales of treasury stock not previously accounted for as constructively retired should be credited to capital surplus; "losses" may be charged to capital surplus to the extent that previous net "gains" from sales or retirements of the same class of stock are included therein, otherwise to retained earnings.

c. Treasury stock delivered to effect a "pooling of interests" should be accounted for as though it were newly issued, and the cost thereof should receive the accounting treatment appropriate for retired stock.

13. Laws of some states govern the circumstances under which a corporation may acquire its own stock and prescribe the accounting treatment therefor. Where such requirements are at variance with paragraph 12, the accounting should conform to the applicable law. When state laws relating to acquisition of stock restrict the availability of retained earnings for payment of dividends or have other effects of a significant nature, these facts should be disclosed.

ARB 43, Chapter 3A — Current Assets and Current Liabilities

14. The following paragraph is added to this chapter:

10. Unearned discounts (other than cash or quantity discounts and the like), finance charges and interest included in the face amount of receivables should be shown as a deduction from the related receivables.

ARB 43, Chapter 5 — Intangible Assets

15. The last sentence of paragraph 7 of Chapter 5 is deleted.

ARB 43, Chapter 7B — Stock Dividends and Stock Split-Ups

16. The Board is of the opinion that paragraph 6 should not be construed as prohibiting the equity method of accounting for substantial intercorporate investments. This method is described in paragraph 19 of ARB 51.

ARB 43, Chapter 9B — Depreciation on Appreciation

17. Paragraphs 1 and 2 are deleted and the following paragraph is substituted for them:

1. The Board is of the opinion that property, plant and equipment should not be written up by an entity to reflect appraisal, market or current values which are above cost to the entity. This statement is not intended to change accounting practices followed in connection with quasi-reorganizations[6] or reorganizations. This statement may not apply to foreign operations under unusual conditions such as serious inflation or currency devaluation. However, when the accounts of a company with foreign operations are translated into United States currency for consolidation, such write ups normally are eliminated. Whenever appreciation has been recorded on the books, income should be charged with depreciation computed on the written up amounts.

Mr. Davidson agrees with the statement that at the present time "property, plant and equipment should not be written up" to reflect current costs, but only because he feels that current measurement techniques are inadequate for such restatement. When adequate measurement methods are developed, he believes that both the reporting of operations in the income statement and the valuation of plant in the balance sheet would be improved through the use of current rather than acquisition costs. In the meanwhile, strong efforts should be made to develop the techniques for measuring current costs.

ARB 43, Chapter 12 — Foreign Operations and Foreign Exchange

18. Paragraphs 12 and 18 state that long-term receivables and long-term liabilities should be translated at historical exchange rates. The Board is of the opinion that translation of long-term receivables and long-term liabilities at current exchange rates is appropriate in many circumstances.

[6] See Accounting Research Bulletin No. 43, Chapter 7A, *Quasi-Reorganization or Corporate Readjustment.*

ARB 43, Chapter 15 — Unamortized Discount, Issue Cost, and Redemption Premium on Bonds Refunded

19. Paragraph 12 is amended to read as follows:

> 12. The third method, amortization over the life of the new issue, is appropriate under circumstances where the refunding takes place because of currently lower interest rates or anticipation of higher interest rates in the future. In such circumstances, the expected benefits justify spreading the costs over the life of the new issue, and this method is, therefore, acceptable. Paragraph 11 of this chapter is applicable when this method is adopted.

ARB 44 (Revised) — Declining-balance Depreciation

20. Pending further study, paragraph 9 is revised to read as follows:

> 9. When a company subject to rate-making processes adopts the declining-balance method of depreciation for income tax purposes but adopts other appropriate methods for financial accounting purposes in the circumstances described in paragraph 8, and does not give accounting recognition to deferred income taxes, disclosure should be made of this fact.

Messrs. Donald J. Bevis, Catlett, Layton, Moonitz, Penney, Schur, and Weston do not agree with paragraph 20 of this Opinion because it deletes a requirement in paragraph 9 of Accounting Research Bulletin No. 44 (Revised) for the disclosure of information they consider to be essential in financial statements. Paragraph 9 has required full disclosure of the effect ". . . arising out of the difference between the financial statements and the tax returns when the declining-balance method is adopted for income-tax purposes but other appropriate methods are used for financial accounting purposes" in the case of companies which (pursuant to paragraph 8) are not required to give accounting recognition to such differences. The intent of para-

graph 20 of this Opinion is to continue the requirement for disclosure of the accounting practice followed but to omit the previous requirement for disclosure of the effect of the practice. Thus, in their opinion, the Accounting Principles Board is inappropriately sponsoring the viewpoint that investors and other users of financial statements should be told of the practice but need not be furnished the information to judge its significance.

21. The letter of April 15, 1959, addressed to the members of the Institute by the Committee on Accounting Procedure, interpreting ARB 44 (Revised), is continued in force.

ARB 48 — Business Combinations

22. The Board believes that Accounting Research Bulletin No. 48 should be continued as an expression of the general philosophy for differentiating business combinations that are purchases from those that are poolings of interests, but emphasizes that the criteria set forth in paragraphs 5 and 6 are illustrative guides and not necessarily literal requirements.

Deferred Income Taxes

23. Provisions for deferred income taxes may be computed either (a) at the tax rate for the period in which the provision is made (the so-called "deferred credit" approach) or (b) at the tax rate which it is estimated will apply in the future (the so-called "liability" approach).[7]

(a) Under the deferred credit method, the accumulated balance is not adjusted for changes in tax rates subsequent to the year of provision. Accordingly, the deferred amount is allocated to (drawn down in) the future periods based on the recorded tax benefit, which may be at a rate different from the then current rate.

(b) Under the liability method, the accumulated balance

[7] For a discussion of this subject see Accounting Research Study No. 7, *Inventory of Generally Accepted Accounting Principles for Business Enterprises,* p. 114.

is adjusted for changes in tax rates subsequent to the year of provision.[8] Accordingly, the deferred amount after adjustment is allocated to (drawn down in) the future periods based on the then current tax rates. All provisions of Accounting Research Bulletins and Board Opinions in conflict with this paragraph are modified accordingly, including Chapter 9C and Chapter 10B of ARB 43 and ARB 44 (Revised).

EFFECTIVE DATE OF THIS OPINION

24. This Opinion shall be effective for fiscal periods that begin after December 31, 1965. However, the Board encourages earlier application of the provisions of this Opinion.

The Opinion entitled "Status of Accounting Research Bulletins" was adopted unanimously by the twenty-one members of the Board, of whom one, Mr. Davidson, assented with qualification as to paragraph 17 and seven, Messrs Donald J. Bevis, Catlett, Layton, Moonitz, Penney, Schur, and Weston assented with qualification as to paragraph 20.

[8] See Accounting Research Bulletin No. 43, Chapter 8 – Paragraph 11.

NOTES

Opinions present the considered opinion of at least two-thirds of the members of the Accounting Principles Board, reached on a formal vote after examination of the subject matter.

Except as indicated in the succeeding paragraph, the authority of the Opinions rests upon their general acceptability. While it is recognized that general rules may be subject to exception, the burden of justifying departures from Board Opinions must be assumed by those who adopt other practices.

Action of Council of the Institute (Special Bulletin, Disclosure of Departures From Opinions of Accounting Principles Board, October *1964) provides that:*

- *a. "Generally accepted accounting principles" are those principles which have substantial authoritative support.*
- *b. Opinions of the Accounting Principles Board constitute "substantial authoritative support".*
- *c. "Substantial authoritative support" can exist for accounting principles that differ from Opinions of the Accounting Principles Board.*

The Council action also requires that departures from Board Opinions be disclosed in footnotes to the financial statements or in independent auditors' reports when the effect of the departure on the financial statements is material.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive. They are not intended to be applicable to immaterial items.

Accounting Principles Board (1965-1966)

APPENDIX A

October, 1964

SPECIAL BULLETIN

Disclosure of Departures From Opinions of Accounting Principles Board

To Members of the American Institute
of Certified Public Accountants

The Council of the Institute, at its meeting October 2, 1964, unanimously adopted recommendations that members should see to it that departures from Opinions of the Accounting Principles Board (as well as effective Accounting Research Bulletins issued by the former Committee on Accounting Procedure) are disclosed, either in footnotes to financial statements or in the audit reports of members in their capacity as independent auditors.

This action applies to financial statements for fiscal periods beginning after December 31, 1965.

The recommendations adopted by Council are as follows:

1. "Generally accepted accounting principles" are those principles which have substantial authoritative support.

2. Opinions of the Accounting Principles Board constitute "substantial authoritative support."

3. "Substantial authoritative support" can exist for accounting principles that differ from Opinions of the Accounting Principles Board.

4. No distinction should be made between the Bulletins issued by the former Committee on Accounting Procedure on matters of accounting principles and the Opinions of the Accounting Principles Board. Accordingly, references in this report to Opin-

ions of the Accounting Principles Board also apply to the Accounting Research Bulletins.[1,2]

5. If an accounting principle that differs materially in its effect from one accepted in an Opinion of the Accounting Principles Board is applied in financial statements, the reporting member must decide whether the principle has substantial authoritative support and is applicable in the circumstances.

a. If he concludes that it does not, he would either qualify his opinion, disclaim an opinion, or give an adverse opinion as appropriate. Requirements for handling these situations in the reports of members are set forth in generally accepted auditing standards and in the Code of Professional Ethics and need no further implementation.

b. If he concludes that it does have substantial authoritative support:

(1) he would give an unqualified opinion and

(2) disclose the fact of departure from the Opinion in a separate paragraph in his report or see that it is disclosed in a footnote to the financial statements and, where practicable, its effects on the financial statements.* Illustrative language for this purpose is as follows:

> The company's treatment of (describe) is at variance with Opinion No. ____ of the Accounting Principles Board (Accounting Research Bulletin No. ____ of the

[1] This is in accord with the following resolution of the Accounting Principles Board at its first meeting on September 11, 1959:

"The Accounting Principles Board has the authority, as did the predecessor committee, to review and revise any of these Bulletins (published by the predecessor committee) and it plans to take such action from time to time.

"Pending such action and in order to prevent any misunderstanding meanwhile as to the status of the existing accounting research and terminology bulletins, the Accounting Principles Board now makes public announcement that these bulletins should be considered as continuing in force with the same degree of authority as before."

[2] The Terminology Bulletins are not within the purview of the Council's resolution nor of this report because they are not statements on accounting principles.

* In those cases in which it is not practicable to determine the approximate effect on the financial statements, this fact should be expressly stated.

Committee on Accounting Procedure) of the American Institute of Certified Public Accountants. This Opinion (Bulletin) states that (describe the principle in question). If the Accounting Principles Board Opinion (Accounting Research Bulletin) had been followed, income for the year would have been increased (decreased) by $________, and the amount of retained earnings at (date) increased (decreased) by $________. In our opinion, the company's treatment has substantial authoritative support and is an acceptable practice.

* * * * *

If disclosure is made in a footnote, the last sentence might be changed to read: In the opinion of the independent auditors, ____________, the company's treatment has substantial authoritative support and is an acceptable practice.

6. Departures from Opinions of the Accounting Principles Board which have a material effect should be disclosed in reports for fiscal periods that begin:

a. After December 31, 1965, in the case of existing Bulletins and Opinions;

b. After the issue date of future Opinions unless a later effective date is specified in the Opinion.

7. The Accounting Principles Board should review prior to December 31, 1965, all Bulletins of the Committee on Accounting Procedure and determine whether any of them should be revised or withdrawn.

8. The Accounting Principles Board should include in each Opinion a notation that members should disclose a material departure therefrom.

9. The failure to disclose a material departure from an Accounting Principles Board Opinion is deemed to be substandard reporting.† The Practice Review Committee should be instructed to give its attention to this area and to specifically report to Council the extent of deviations from these recommendations.

10. The Committee on Professional Ethics and the Institute's legal counsel have advised that the present By-Laws and Code of Professional Ethics would not cover an infraction of the above recommendations. Whether the Code of Professional Ethics should be amended is a question which should be studied further.‡

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As indicated in the above text, Council's action is not intended to have the force and effect of a rule of ethics, but rather that of a standard of reporting practice, deviations from which should have the attention of the Practice Review Committee.

Yours truly,

THOMAS D. FLYNN, *President*

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† In discussion at the Council meeting it was explained that the phrase "substandard reporting" was used in the sense of reporting practices not in conformity with recommendations of the Council.

‡ By order of the Council a special committee is now reviewing the entire matter of the status of Opinions of the Accounting Principles Board, and the development of accounting principles and practices for the purpose of recommending to Council a general statement of philosophy, purpose and aims in this area.